SAS SENATE ANALYSIS SECTION
Lansing, Michigan 48909

Senate Bill 81 (as passed by the Senate)
Sponsor: Nick Smith
Committee: Finance

Date Completed: 3-26-87

RATIONALE

Under a farm loan program created by Public Act 242 of 1986, the State Treasurer is authorized to invest up to $200 million of the Common Cash Fund in certificates of deposit or other instruments of financial institutions, in order to enable them to make "qualified agricultural loans" to eligible Michigan farmers. Because the State Constitution prohibits the State from making deposits to a financial institution in excess of 50% of the institution's net worth, the Act also permits financial institutions to make farm loans out of their own deposits. Although these institutions receive interest from the State, the Attorney General has ruled that the program does not allow the financial institutions to recover their administrative costs of processing the loans. As a result, only about half of the $200 million has been committed. In order for the loan program to be implemented fully, some people believe that financial institutions should be reimbursed for their costs.

CONTENT

The bill would amend Public Act 105 of 1855, which regulates the disposition of surplus State funds, to do the following:

- **Increase the amount that certain financial institutions may receive from the State for making agricultural loans, in order to reimburse the institutions for their administrative costs.**
- **Allow the State Treasurer to certify farmers' losses.**

Administrative Costs

Under the Act's 1986 farm loan program, a participating financial institution may make State-subsidized loans to qualified farmers by using existing deposits for the loans and receiving from the State Treasurer an amount equal to interest that otherwise would have been charged by the financial institution under certain circumstances. The bill provides that a financial institution could receive the amount of interest that would have been charged "on an amount equal to 100% or more of the qualified agricultural loan as determined by the Department of Treasury".

The bill also would allow the State Treasurer to take any necessary action to ensure the successful operation of the Act's farm loan section, including making investments with financial institutions to cover the administrative and risk-related costs associated with a qualified agricultural loan. This language would replace the current requirement that the State Treaurer take any necessary action to ensure that money for purposes of qualified agricultural loans is fully invested and used for such loans.

Additional Provisions

The Act provides that an investment agreement between the State and a financial institution must provide that the financial institution does not have to repay any principal within the first three years after the investment is made. Under the bill, however, repayment of principal could be required within the first three years if the investment were no longer being used to make a qualified agricultural loan or to the extent the loan had been repaid. The bill also provides for approval by the State Treasurer of the terms of the loans.

The bill would allow the State Treasurer to certify a farmer's loss of 25% in major enterprises or 50% in production in any one crop. Currently, only the Agricultural Stabilization and Conservation Service can certify a loss.

MCL 21.142a

BACKGROUND

Public Act 12 of 1985 authorized the State Treasurer to invest up to $70 million of the Common Cash Fund in certificates of deposit or other instruments of financial institutions to enable the institutions to make low-cost loans to eligible farmers. To qualify, a farmer may not have over $100,000 in outstanding agricultural loans, including the loan the farmer is applying for, and must be experiencing difficulty meeting existing or projected debts at market interest rates. A loan may be used for the repair of agricultural equipment or machinery; the purchase of used replacement equipment or machinery; operating capital needed for such things as seed, feed, livestock, breeding stock, and fertilizer; and refinancing a loan made before the Act took effect. Due to an overwhelming response to the program, Public Act 90 of 1985 increased to $139 million the amount that the State Treasurer is authorized to invest.

When last year's September floods devastated many farms, the Legislature passed Public Act 242 of 1986 to create a new farm loan program modeled on the 1985 program, and to authorize the State Treasurer to invest up to $200 million in financial institutions. To qualify under the new program, a farmer must have had losses of 25% in major enterprises or 50% in the production of any one crop. The amount of a loan is the value of the crop loss minus the amount of a payment-in-kind (PIK) grant or proceeds of insurance on the crop, but cannot exceed $200,000. Until June 30, 1988, a financial institution may use its deposits to make State-subsidized farm loans under either the 1986 or the 1985 program, and receive from the State an amount equal to the lesser of the following: the interest that would be charged by the financial institution on the loan "if the distribution . . is not appropriated", or the interest that would have been earned on the loan if the rate charged for each quarter were equal to the average rate earned by the State during that quarter on surplus funds investments other than emergency farm loans and certain other loans. Any money remaining from the $200 million that has not been loaned out by June 30, 1987, "rolls over" into the 1985 program, whose loans were extended until June 30, 1988.

FISCAL IMPACT

The bill would have no fiscal impact on State or local government. Senate Bill 81 proposes to make technical changes to insure that State loans to farmers are implemented in a timely manner

ARGUMENTS

Supporting Argument

By enabling the State to reimburse financial institutions for their administrative costs, the bill would remove an impediment to the full implementation of the 1986 farm loan program. A number of banks are at their constitutional limit for State investments, and must invest their own deposits if they are to participate in the program. These banks make loans to farmers at below-market interest rates and then receive from the State the difference between the loan rate and the market rate of interest. They do not receive, however, anything to cover their administrative costs of processing the loans, and therefore are reluctant to participate in the program. By allowing the State to pay more than just the interest, the bill would remove the reason for the banks' reluctance and facilitate full implementation of the loan program.

Response: While the bill would improve the situation, another factor contributing to banks' hesitancy to particpate would remain. Under the Act, the amount of a loan must be reduced by the amount of any PIK grants received by the farmer. Because Congress may increase those grants, however, a bank may find that it has violated the law by lending more than it should have.

Supporting Argument

By allowing the Department of Treasury to certify a farmer's loss, the bill would speed up the processing of these loans and enable the farmer to receive the loan in time to purchase seed and get it into the ground. Under the current system, a farmer's loss may be certified only by the federal Agricultural Stabilization and Conservation Service, which may not be able to certify the loss on time.

Opposing Argument

Agricultural business loans should be included among the loans authorized by the Act, in order to address the needs of others who also were hurt by last year's flooding, but who were hurt indirectly. Various businesses — particularly dry bean elevators, but also the cherry industry, vegetable processors, implement dealers, and others — are largely dependent upon successful agriculture for their own survival. The dry bean industry reports that up to two-thirds of that crop was destroyed or abandoned in the field because of the rains, and the industry has been unable to deliver on its contracts. Because the dry bean market is international, and Michigan farmers don't come close to meeting its needs, our share of the market could disappear unless the industry is able to get back on its feet within several years.

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